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January 24, 2008

To: Supervisor Yvonne B. Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: William T Fujioka
Chief Executive Officer

SACRAMENTO UPDATE

Legislative Analyst's Office Analysis of the Health Care Reform Proposal

On January 22, 2008, as requested by Senate President pro Tem Don Perata, the Legislative Analyst's Office (LAO) released its fiscal analysis of the proposed Health Care Reform (HCR) plan currently under consideration by the Legislature. The HCR plan consists of two parts: 1) ABX1 1, the Health Care Security and Cost Reduction Act, as amended on January 16, 2008, which passed the Assembly on December 17, 2007 and 2) the related ballot initiative, the Secure and Affordable Health Care Act of 2008, intended to be placed on the November 2008 general election ballot.

Senator Perata asked the LAO to address three questions: 1) What are the expected revenues and costs of the reform plan once implemented, and how will those change after five years; 2) What risks, cost pressures, and implications does the plan present to the State General Fund; and 3) How does the Governor's FY 2008-09 Proposed Budget affect the reform plans underlying finances.

The LAO considers this report a preliminary financial assessment, and indicates that they are in the process of gathering additional information for the Attorney General's Office regarding the proposed ballot initiative. As a result, estimates may change subsequent to analysis of this new information. A summary of the LAO's analysis follows.

Revenues and Costs. The LAO estimated the fiscal impact of HCR using two different assumptions regarding premium rates: 1) a \$250 per member per month rate assumed by the proponents, and 2) a \$300 per member per month rate which the LAO considers more likely to be achievable. The LAO believes a \$250 per member per month rate may be difficult to achieve noting that the average monthly premium for individuals with employer coverage was \$374 in 2007. The LAO concludes that in order to provide premium levels of \$250, the State will need to either negotiate a much lower rate than the average employer or set the minimum benefit level substantially below the average employer-based benefit level.

Under the \$250 premium assumption, the LAO indicates that there would be sufficient revenues to support the program in the first year of operation (FY 2010-11). However, by the fifth year of the program, annual costs would exceed revenues by \$300 million. Despite this imbalance in the fifth year, the program would still have available funds as the collection of tobacco tax is scheduled to begin on May 1, 2009 and employer fees on January 1, 2010, prior to program costs being incurred. Under the \$300 premium assumption, the LAO estimates that costs would exceed revenues by \$122 million in the first year of program implementation, and this shortfall would increase to \$1.5 billion by the fifth year of the program. The fund balance would show a cumulative deficit of almost \$4 billion by the end of that period, in spite of early collection of tobacco tax and employer fees.

Other Risks, Cost Pressures, and Implications for the State General Fund. The LAO finds that approximately \$1.1 billion of the \$4.4 billion in Federal matching funds assumed by the reform plan are at risk. While \$3.3 billion is likely to be available without the need to amend current Federal waivers or obtain new waivers, the LAO anticipates that a new waiver would be needed to provide an estimated \$1.1 billion in new or redirected Federal matching funds annually. New administrative restrictions for states seeking to expand Federally-funded health coverage programs beyond 250 percent of the Federal Poverty Level (FPL) create risk that the funding for the Healthy Families Program expansion above 250 percent of FPL, which is assumed by the HCR plan, would not be available. Because estimates for the uninsured vary, the LAO indicates that there is a risk that the proponent's estimate may be too low, indicating that more uninsured would increase costs by hundreds of millions of dollars.

The LAO also indicates that ABX1 1 increases the State's General Fund exposure for In-Home Supportive Services (IHSS) costs as it raises the total level of State participation. The LAO estimates the cost exposure to be \$40 million in FY 2010-11, increasing to \$145 million in FY 2014-15. The LAO further notes that it is unclear whether the State, Federal, and/or county governments would be responsible for employer contributions for expanded health care coverage for IHSS providers under the measure.

Other risks identified by the LAO include the potential for an economic slowdown causing Californians to lose access to existing employer-provided healthcare, higher growth in medical inflation costs compared to revenues, and the possibility that individuals who choose a public plan would be less healthy than the average insured individual, all of which would result in higher than anticipated costs.

The LAO noted the following implications for the State General Fund:

- **Funding Source Outside State Control** – The HCR plan places a heavy reliance on the availability of Federal funds, while the Federal budget is facing serious fiscal challenges. To the extent that these funds are not available, there will be additional expenditure pressure on the State General Fund.
- **Funding Source Sunsets in 2015** – The hospital fee contained in the proposed ballot initiative is scheduled to sunset on July 1, 2015. Unless reauthorized, this would place additional pressure on the State General Fund.
- **Access to Medical Care** – According to the proponent's estimates, implementation would result in more than 3.5 million individuals becoming dependant on HCR for health care coverage. Terminating the program due to funding shortfalls would represent a hardship and create a serious disruption in access to medical care for these participants. Significant public pressure would be placed on the State to continue to fund the program through the State General Fund.

Impact of the State Budget on Reform Plan Finances. The LAO finds that in some cases, the Governor's Budget appears to conflict with the HCR proposal. For example, the Governor's Budget proposes to reduce provider payments for physicians and other medical providers to save approximately \$602 million in FY 2008-09. However, the HCR proposal assumes a \$500 million rate increase for Medi-Cal physicians in FY 2010-11, subject to appropriation by the Legislature. The Governor's Budget does not anticipate any HCR implementation activities in FY 2008-09, although the proponents have identified costs of about \$110 million for such activities, which would be incurred in late 2008 or early 2009. Similarly, HCR will require changes in existing information technology systems and the development of new systems. Revenue sources to pay for these changes have not been identified. Under the proposal, the first HCR revenues would not be available until May of 2009.

Conclusion. The LAO finds that any plan to reform the State's health care system will involve financial risk over the long term. Further, the LAO concludes that many of the risks identified above would be shared by any health reform plan that attempts to maintain the current system of employer-based coverage while expanding public programs to cover the uninsured.

The complete analysis of the proposed HCR plan is available on the LAO's website at: <http://www.lao.ca.gov>.

Senate Health Committee Hearing on Health Care Reform—Vote Delayed

County-support and amend ABX1 1 (Nuñez), which would enact the Health Care Security and Cost Reduction Act, was heard on January 23, 2008 in the Senate Health Committee, but a vote on the bill was delayed until Monday, January 28, 2008. Senate President pro Tempore Don Perata asked that the vote be delayed to give Committee members additional time to review the bill and the LAO analysis of the Health Care Reform proposal.

The Senate Health Committee heard 11 hours of testimony, including Assembly Speaker Fabian Nuñez, the Administration, LAO, and numerous stakeholders. Health Services Director and Chief Medical Officer, Dr. Bruce Chernof, testified on behalf of the County. Dr. Chernof articulated the County's support of the bill indicating it will provide fiscal stability for the County's Department of Health Services and that the creation of the Local Coverage Option will provide public hospital counties with a stable patient base during the first few years of health care reform implementation. Dr. Chernof also stated that the County is seeking an amendment to ABX1 1 to exempt the County from the In-Home Supportive Services (IHSS) Trust Fund provision because the County already provides health coverage to the IHSS population through our Community Health Plan.

Legislative Analyst Elizabeth Hill provided Committee Members with an overview of the LAO analysis of the bill. As noted in the summary of the LAO report provided above, Ms. Hill outlined several risks of the bill, including the assumption of a \$250 monthly premium for health care coverage, approximately \$1.1 billion in Federal matching funds being at risk, and increased State participation rates in IHSS negatively impacting the State's General Fund.

Several Committee members, including the Chair, Senator Sheila Kuehl, and Senators Leland Yee, Darrell Steinberg, and Gloria Negrete-McLeod expressed their concern over the fiscal viability of the plan, especially since the State is facing a \$14.5 billion budget shortfall over the next 18 months. Members also expressed concern about the monthly premium. They argued that if the premium is too low, they would be enacting an underfunded health care reform plan.

In his closing remarks, Assembly Speaker Fabian Nuñez noted that he has spent over a year working on fixing California's broken health care system, including working with the Governor on a plan that is expected to cover 70 percent of California's uninsured. He acknowledged that the bill is not perfect, but it is an improvement over the status quo.

He advised Members that this bill is a compromise and deserves their fair consideration. In addition, Assembly Speaker Nuñez stated that he believes the voters will approve the Secure and Affordable Health Care Act Initiative, which is expected to be placed on the November 2008 ballot.

The Senate Health Committee will reconvene on Monday, January 28, 2008 upon adjournment of the Senate. Senator Kuehl and other Committee Members are expected to make their closing remarks at that time.

Status of County Advocacy Legislation

County-supported AB 20 (Eng), as amended on January 8, 2008, which would authorize the Attorney General to contract for a study on successful strategies to resolve intergroup conflicts, passed the Assembly Judiciary Committee on January 15, 2008 by a vote of 9 to 1. AB 20 now proceeds to the Assembly Appropriations Committee, where it awaits a hearing.

We will continue to keep you advised.

WTF:GK
DD: MS:hg

c: All Department Heads
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